

**STATE OF WASHINGTON
OFFICE OF THE INSURANCE
COMMISSIONER**



FINANCIAL EXAMINATION

of

**Group Health Cooperative
Seattle, Washington**

**NAIC CODE 95672
DECEMBER 31, 2003**

**Group Health Cooperative
Order No. G06-52
Exhibit A**

SALUTATION

Seattle, Washington
September 1, 2006

The Honorable Mike Kreidler, Commissioner
Washington State Office of the Insurance Commissioner (OIC)
Insurance Building – Capitol Campus
302 – 14th Avenue SW
Olympia, WA 98504

Dear Commissioner Kreidler:

In accordance with your instructions, and in compliance with the statutory requirements of RCW 48.46.120 and RCW 48.03.010, an examination was made of the corporate affairs and financial records of

Group Health Cooperative

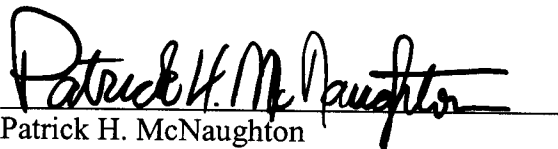
of

Seattle, Washington

hereinafter referred to as "GHC" or the "Company," at the location of its home office, 521 Wall Street, Seattle, Washington 98121. This report is respectfully submitted showing the condition of the Company as of December 31, 2003.

CHIEF EXAMINER'S AFFIDAVIT

I hereby certify I have read the attached Report of the Financial Examination of Group Health Cooperative of Seattle, Washington. This report shows the financial condition and related corporate matters as of December 31, 2003.



Patrick H. McNaughton
Chief Examiner

9-1-06

Date

TABLE OF CONTENTS

SCOPE OF THE EXAMINATION.....	1
INSTRUCTIONS.....	1
COMMENTS AND RECOMMENDATIONS.....	6
COMPANY PROFILE	8
Company History.....	8
Capitalization.....	8
Territory And Plan Of Operation.....	8
Growth Of Company	8
AFFILIATED COMPANIES	9
Group Health Options, Inc.....	9
Group Health Community Foundation	9
Group Health Services, Inc.....	9
Group Health of Washington.....	9
INTERCOMPANY AGREEMENTS	10
Administrative Services Agreement.....	10
Medical Services Agreement.....	10
Contribution Agreement	10
MANAGEMENT AND CONTROL	10
Ownership.....	10
Board of Trustees.....	11
Officers	11
Conflict of Interest.....	11
Fidelity Bond and Other Insurance.....	11
Officers', Employees', and Agents' Welfare and Pension Plans	12
ACTUARIAL REVIEW	12
REINSURANCE.....	13
STATUTORY DEPOSITS	13
ACCOUNTING RECORDS AND INFORMATION SYSTEMS	14
SUBSEQUENT EVENTS	15
FINANCIAL STATEMENTS	15
Assets, Liabilities, Capital and Surplus.....	16
Statement of Revenue and Expenses.....	17
Five Year Reconciliation of Surplus	18
NOTES TO THE FINANCIAL STATEMENTS	19
ACKNOWLEDGMENT.....	20
AFFIDAVIT	21

SCOPE OF THE EXAMINATION

This examination covers the period January 1, 1999 through December 31, 2003 and comprises a comprehensive review of the books and records of the Company. The examination followed the statutory requirements contained in the Washington Administrative Code (WAC), the Revised Code of Washington (RCW), and the guidelines recommended by the National Association of Insurance Commissioners (NAIC) Financial Condition Examiners Handbook. The examination included identification and disposition of material transactions and events occurring subsequent to the date of examination that were noted during the examination.

Corporate records, external reference materials, and various aspects of the Company's operating procedures and financial records were reviewed and tested during the course of this examination and are commented upon in the following sections of this report. In addition, the Company's certified public accountant's (CPA's) work papers were reviewed and utilized, where possible, to facilitate efficiency in the examination.

INSTRUCTIONS

The examiners reviewed the Company's filed 2003 NAIC Annual Statement as part of the statutory examination. This review was performed to determine if the Company completed the NAIC Annual Statement in accordance with the NAIC Annual Statement Instructions and to determine if the Company's accounts and records were prepared and maintained in accordance with Title 48 RCW, Title 284 WAC, and the NAIC Statements of Statutory Accounting Principles (SSAP) as contained in the NAIC Accounting Practices and Procedures Manual (AP&P).

The following summarizes the exceptions noted while performing this review.

1. NAIC Annual Statement Errors

The results of the examination disclosed several instances in which the Company's filing of the 2003 NAIC Annual Statement did not conform to the NAIC Accounting Practices and Procedures Manual and the NAIC Annual Statement Instructions.

a. SVO reporting, rating, and monitoring

The Company is not monitoring the rating of its securities, as required by the NAIC Purposes and Procedures of the NAIC Securities Valuation Office (SVO) Manual. Specifically, it does not monitor its Provisionally Exempt (PE) securities and has no policy to do so.

The Company is not reporting its securities to the SVO as required by the SVO Manual. The Company's current process is to search the Valuation of Securities (VOS) database for the acquired security. If the security is not listed in the VOS database, the Company searches for similar securities with the same issuer and uses the NAIC designation for the similar security, followed by a Z which indicates the Company valued the security itself.

All securities not listed with the SVO must be reported within 120 days. GHC is not reporting these securities.

In addition, securities that were reported with a Z identifier in the 2002 NAIC Annual Statement, and have been reported as such for more than one year, were not reported in the 2003 NAIC Annual Statement with the designation 6* as required in the SVO Manual, Part 3, Section 2, pursuant to requirements in the SVO Manual, Part 4, Section 3.

The Company also filed an inaccurate 2003 SVO Compliance Certification pursuant to the examination findings and instructions regarding SVO reporting, rating and monitoring as noted above. The 2003 SVO Compliance Certification was marked as being in compliance, when in fact, the Company was not in compliance regarding SVO reporting, rating and monitoring.

The Company stated it was not aware of the reporting, record keeping, and monitoring requirements of PE securities and Z designated securities. The Company relied on the VOS publication alone to provide exemption status. For the year 2003, each security the Company declares as PE, the Company must maintain a record supporting its decision to declare the security as provisionally exempt and include in the documentation evidence of continued monitoring. For Z designated securities, the Company must determine analytically a value and then submit an application to the SVO for valuation of the security within 120 days of the date the security was acquired.

For the year ended December 31, 2003, the Company listed 38 securities with a PE designation and 35 with a Z designation. In our review, we determined that all of the Z designated securities were provisionally exempted and should have been designated PE not Z.

b. Unearned premiums/Premiums received in advance

GHC reported a total of \$48,845,149 as Unearned premium reserves in the 2003 NAIC Annual Statement which was reflected in the balance sheet as Aggregate health policy reserves. However, it was determined the total amount consisted of the following three items:

- 1) \$40,965,125 was determined to be Premiums received in advance. (See examination report reclassification adjustment No. 1, debiting Aggregate health policy reserves and crediting Premiums received in advance.)
- 2) \$45,123 was determined to be a rental deposit for GHC space rented to an external entity (See examination report reclassification adjustment No. 1, debiting, Aggregate health policy reserves and crediting, Amounts withheld or retained for the account of others.)
- 3) \$7,834,901 was determined to be for grant studies, also a type of escrow account. (See examination report reclassification adjustment No. 1, debiting Aggregate health

policy reserves and crediting, Amounts withheld or retained for the account of others.)

c. Contracts subject to retrospective rating

The Company has two contracts subject to retrospective rating. Pursuant to SSAP No. 66, paragraph 8, retrospective premium adjustments are estimated for the portion of the policy period that has expired and shall be considered an immediate adjustment to premium. Examiners determined by review of the Company work papers that retrospective premiums were not accrued as required as of December 31, 2003. No examination adjustment is recommended due to immateriality.

No evidence was provided to establish that any accounting entries as of December 31, 2003 were prepared for accrued retrospective rating premiums nor were accrued retrospective rating premiums reported in the 2003 NAIC Annual Statement, Assets, Page 2, Line 12.3. In addition, GHC did not prepare a complete disclosure pursuant to the statutory reporting requirements. SSAP No. 66, paragraphs 12-14 discusses NAIC Annual Statement disclosure of retrospective rating contracts.

d. General expenses due and accrued

Commission expense in the amount of \$4,008,868 was not reported correctly in the 2003 NAIC Annual Statement, Underwriting and Investment Exhibit, Part 3 – Analysis of Expenses. Commissions were allocated to various general administrative expense lines in Column 2 when the whole amount should have been reported on Commissions, Line 3, Column 2, pursuant to NAIC Annual Statement Instructions. No examination reclassification adjustment was necessary because the error occurred on a supporting exhibit and commissions were reflected properly in the net result in the Statement of Revenue and Expenses.

e. Miscellaneous payroll deductions

The 2003 NAIC Annual Statement Instructions and SSAP No. 67 clearly define miscellaneous payroll deductions to be included in Amounts withheld for account of others. GHC erroneously reported \$3,389,591 of payroll withholdings as General expenses due and accrued. (See examination report reclassification adjustment No. 2, debiting General expenses due or accrued, and crediting Amounts withheld or retained for the account of others.)

f. Health care delivery assets

The Company reported the inventory of health care supplies under Aggregate write-ins for other than invested assets. The entire inventory in the amount of \$24,037,457 should be reclassified to Furniture and equipment, including health care delivery assets pursuant to the definitions in SSAP No. 73. (See examination report reclassification adjustment No. 4, debiting Furniture and equipment, including health care delivery assets and crediting, Aggregate write-ins for other than invested assets, inventories.)

g. Unclaimed property (outstanding checks and drafts)

Chapter 63.29 RCW, The Uniform Unclaimed Property Act, defines outstanding checks and drafts as unclaimed property. Unclaimed property, outstanding after five years, is

subject for remittance to the state of Washington as unclaimed property. The Company erroneously reported \$1,443,533 in unclaimed checks and drafts as General expenses due or accrued. The 2003 NAIC Annual Statement Instructions require these balances to be reported as Aggregate write-ins for other liabilities and specifically named under details of write-ins. (See examination report reclassification adjustment No. 3, debiting General expenses due and accrued and crediting, Aggregate write-ins for other liabilities, unclaimed property.)

h. Affiliated companies and transaction disclosures

Group Health Services, Inc. (GHS) is a Washington stock corporation and GHC owns 100% of the stock. GHS is inactive at the present time with regards to business activity. GHS is not reported as an affiliate in the GHC 2003 NAIC Annual Statement pursuant to the NAIC 2003 Annual Statement Instructions.

Group Health of Washington (GHWA) is a Washington nonprofit membership corporation. GHC trustees are the sole members of GHWA. GHWA has no assets and is inactive at the present time with regards to business activity. GHWA is not reported as an affiliate in the GHC NAIC 2003 Annual Statement pursuant to the NAIC 2003 Annual Statement Instructions.

The 2003 NAIC Health Annual Statement Instructions (page 195) require "All insurers and reporting entity members of a holding company group..." to be listed on Sch. Y, Part 1, Organizational Chart. GHS and GHWA qualify as "reporting entity members," and should be included in the Organizational Chart.

There is also no mention of GHS or GHWA in Note No. 10 of the 2003 NAIC Annual Statement. The 2003 NAIC Health Annual Statement Instructions (page 117) requires annual statement disclosure of all material related party transactions. SSAP No. 25, paragraph 17.g., states that the relationship shall be disclosed, even though there are no transactions between the enterprises.

i. Actual paid claim amounts

The Company estimated the amount of claims paid in 2003 that were for claims incurred in prior years instead of using actual amounts. The total of claims paid in year 2003 that were for claims incurred in prior years was estimated by the Company at 13% of total claims paid in year 2003. The NAIC Annual Statement Instructions requires that the Underwriting and Investment Exhibit, Part 2B, columns (1) and (2) of the NAIC Annual Statement should include actual payments only.

j. Active life reserves were misclassified in the 2003 NAIC Annual Statement

Active life reserves in the amount of \$3,094,928 were misclassified in the 2003 NAIC Annual Statement as Aggregate write-ins for other liabilities. The 2003 NAIC Annual Statement Instructions requires active life reserves to be recorded in the NAIC Annual Statement as Aggregate health policy reserves. (See examination report reclassification adjustment No. 5, debiting Aggregate write-ins for other liabilities, active life reserves, and crediting, Aggregate health policy reserves.)

The Company is instructed to comply with RCW 48.46.080 and file an accurate statement of its financial condition, transactions, and affairs; with RCW 48.43.097 which requires the filing of its financial statements in accordance with the NAIC AP&P Manual; and with WAC 284-07-050(2) which requires adherence to the NAIC Annual Statement Instructions and the NAIC AP&P Manual.

2. Investment Custodial Agreements

The Company's custodial and safekeeping agreements with the Bank of New York (BNY) and the Bank of America (BOA) do not contain all the custodial agreement criteria as required by the 2003 NAIC Financial Condition Examiners Handbook (FCEH), Part 1 - General, Section IV.J. The 2003 NAIC Annual Statement Instructions for General Interrogatory No. 23 requires investment custodial safekeeping agreements to include language as required by the NAIC FCEH.

The Company also incorrectly listed BNY and BOA in General Interrogatory No. 23.01 on page 30 of the 2003 NAIC Annual Statement as having custodial agreements that comply with the NAIC FCEH.

The Company is instructed to amend its custodial agreements with BNY and BOA to include the appropriate wording and criteria as set forth in the NAIC FCEH pursuant to WAC 284-07-050(2) which requires adherence to the NAIC Annual Statement Instructions.

In connection with the incorrect statement in General Interrogatory No. 23.01, the Company is also instructed to comply with RCW 48.46.080 and file an accurate statement of its financial condition, transactions, and affairs.

3. The Actuary Must Opine on All Required Items

The consulting health actuary stated in the certified Statement of Actuary Opinion (SAO) that the following amounts were not reviewed:

- \$1,237,064 Medicare Reconciliation Adjustments
- \$7,634,117 Contract Reconciliations for Claims Unpaid Estimate
- \$146,789 Accrued Medical Incentive Pool
- \$48,845,149 Aggregate Health Policy Reserves
- \$0 Aggregate Health Claim Reserves
- \$0 Experience Rated Refunds

The NAIC Annual Statement Instructions requires the actuary to form an opinion on the items listed above.

In addition, the consulting health actuary should have opined on the active life reserves in the amount of \$3,094,928 and should have reviewed the medical claim history for experience rated contracts to determine if any experience refund reserves were required.

WAC 284-07-060(2)(a) requires each health carrier to include with its NAIC Annual Statement a statement of actuarial opinion setting forth the actuary's opinion related to the insurer's reserves and other actuarial items, prepared in accordance with the appropriate NAIC Annual Statement Instructions and NAIC AP&P Manual.

The Company is instructed to comply with WAC 284-07-060(2)(a) and include a SAO that is in compliance with the NAIC Annual Statement Instructions and NAIC AP&P Manual pursuant to RCW 48.43.097.

4. Health Carrier Holding Company Act Failure to Report

Pursuant to RCW 48.31C.040, the Company is required to list all affiliates in Form B, Health Carrier Holding Company System Annual Registration Statement. GHS and GHWA were not included in Form B, Health Carrier Holding Company System Annual Registration Statement to the OIC for the reporting years 2001, 2002 and 2003.

The Company is instructed to comply with RCW 48.31C.040 and register with the OIC, reporting all information required for all companies in the holding company system.

COMMENTS AND RECOMMENDATIONS

1. Disaster Recovery Plan

The Company does not have a formal, written and tested disaster recovery plan.

It is recommended that the Company write, test and implement a disaster recovery plan that includes appropriate escalation procedures to resolve operational failures of the information systems (IS) in a timely manner, as recommended by the NAIC.

2. Business Contingency Plan

The Company does not have a business contingency plan for the administrative operations, based on a business impact analysis, which has been tested, and addresses all significant business activities, including financial functions, telecommunication services, data processing, and network services.

It is recommended that GHC implement a business contingency plan to address the continuation of all significant business activities, including financial functions, telecommunication services, and data processing services, in the event of a disruption of normal business activities, as recommended by the NAIC. The plan should be in written format with copies kept in relevant off-site locations. The plan should include a restoration priority for all significant business activities, a list of critical computer programs, applications and data files, and a list of supplies needed to perform manual operations. The plan must clearly describe senior management's roles and responsibilities associated with the declaration of an emergency and identify specifically the officers who are authorized to declare an emergency and to initiate implementation

of the plan. The ultimate responsibility for implementing a business contingency plan resides with the Board of Trustees.

3. Secured Program Holding Region

GHC uses computer software called, ChangeMan, to control changes to program files. However, programmers still have access to a file after it has been reviewed and approved and have the ability to include unauthorized changes prior to moving the file into production.

It is recommended that a secured region on the network be created for the purpose of holding changed programs prior to being migrated into the secured production region. When a changed program has been tested, reviewed, and approved the reviewer should immediately transfer the approved program files to the secured holding region of the network, thus preventing unauthorized changes by a programmer. Currently, the reviewed and approved programs are not secured and a programmer has the ability to insert unauthorized changes after the review. The unauthorized changes would then be transferred into the secured production region without management's knowledge.

4. Record Retention Plan

The record retention and disposition standards policy does not include any of the specific information required to comply with GHC's standards. The policy does not identify the specific types of records to be retained, the retention period for each record type, and the primary holder for each record type. The policy does not provide any information that can be used to verify compliance with the retention policy.

It is recommended that GHC revise the record retention and disposition standards policy to include specific details relevant to the types of records being retained, the retention period for each type of record, and the primary holder for each type of record.

5. Alternative Data Processing Site

GHC does not have a written agreement or contract for the use of an alternative data center in the event the data facility necessitates relocation. Subsequent to the examination period, GHC began building a systems recovery site at its facility located in Spokane, Washington as a hot site, but there are no formal written procedures that identify the procedure for relocation of data processing operations. NAIC guidelines recommend procedures be formalized in written format and regularly tested to ensure data processing operations can be restored in a timely manner. Until the Spokane facility is operational, GHC does not have arrangements for an alternative site.

It is recommended that GHC prepare formal written procedures for the relocation of data processing operations to a specific alternative site and that the procedures be tested regularly to ensure that data processing operations can be restored in a timely manner.

COMPANY PROFILE

Company History

Group Health Cooperative was organized in 1945 in the state of Washington and received its original certificate of registration on April 7, 1976 as a health maintenance organization (HMO) pursuant to Chapter 48.46 RCW. The Company changed its name effective December 31, 2002, from Group Health Cooperative of Puget Sound by dropping the words "of Puget Sound".

Capitalization

Minimum net worth requirements pursuant to RCW 48.46.235 are met with approximately \$300 million in gross paid in and contributed surplus and unassigned funds as of December 31, 2003.

Territory and Plan of Operation

GHC owns and operates its own medical facilities throughout the state of Washington and hires medical support personnel to staff them. GHC contracts with Group Health Permanente, P.C. (GHP), an independent contractor, for the provision of medical services. GHC also contracts with outside medical providers on a fee-for-service or capitated basis for services unavailable through its own facilities.

Growth of Company

The following reflects the growth of the Company as reported in its filed NAIC Annual Statement for the five year period under examination:

	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>
Assets, Liabilities, Capital and Surplus:					
Admitted Assets	\$591,237,495	\$596,167,551	\$649,117,373	\$663,385,515	\$774,397,796
Liabilities	<u>464,970,654</u>	<u>444,489,601</u>	<u>477,031,430</u>	<u>487,181,415</u>	<u>473,985,093</u>
Capital and Surplus	<u><u>126,266,841</u></u>	<u><u>151,677,950</u></u>	<u><u>172,085,943</u></u>	<u><u>176,204,100</u></u>	<u><u>300,412,703</u></u>
Revenue and Expenses:					
Premiums Earned	1,164,618,145	1,246,220,593	1,419,739,339	1,609,655,258	1,803,681,429
Net Underwriting Deductions	<u>1,169,668,354</u>	<u>1,235,594,744</u>	<u>1,413,863,143</u>	<u>1,599,219,383</u>	<u>1,656,215,612</u>
Underwriting Gain or Loss	<u>(5,050,209)</u>	<u>10,625,849</u>	<u>5,876,196</u>	<u>10,435,875</u>	<u>147,465,817</u>
Investment and Other Income		<u>13,525,193</u>	<u>14,972,343</u>	<u>(17,399,186)</u>	<u>40,348,854</u>
Pre-Tax Income	<u>(5,050,209)</u>	<u>24,151,042</u>	<u>20,848,539</u>	<u>(6,963,311)</u>	<u>187,814,671</u>
Taxes Incurred					
Net Income	<u><u>(\$5,050,209)</u></u>	<u><u>\$24,151,042</u></u>	<u><u>\$20,848,539</u></u>	<u><u>(\$6,963,311)</u></u>	<u><u>\$187,814,671</u></u>

AFFILIATED COMPANIES

Group Health Options, Inc. (GHO)

GHC created a wholly owned subsidiary, Options Health Care, Incorporated in 1990. Options Health Care, Incorporated was issued a certificate of registration as a health care service contractor (HCSC) in the state of Washington on October 23, 1990. The name was changed in December 2002 to Group Health Options, Inc. (GHO). An administrative services agreement (ASA) was prepared between GHC and GHO wherein GHC contracted to provide a wide range of administrative support services to GHO. GHC and GHO also entered into a medical services agreement (MSA) through which GHC agreed to provide or arrange medical services to enrollees of GHO on a capitated basis.

Group Health Community Foundation (GHCF)

GHCF (formerly the Group Health/Kaiser Permanente Community Foundation) is a Washington nonprofit corporation organized September 28, 1983, and a supporting organization to GHC under section 509(a) of the Internal Revenue Code. GHCF is registered in the state of Washington as a Charitable Gift Annuity Organization and is organized exclusively to benefit, to perform the functions of, and to carry out the purposes of GHC by securing, investing, and allocating charitable gifts in order to support research, health careers training, health education, and other charitable programs that support the purpose of GHC. GHCF is a membership corporation and has no capital stock. The membership of GHCF consists of those persons elected as trustees of GHC, in their official capacities as GHC trustees.

Group Health Services, Inc. (GHS)

GHS is a Washington stock corporation and GHC owns 100% of the stock. GHS is inactive at the present time with regards to business activity.

GHC has not reported GHS as a subsidiary pursuant to Chapter 48.31C RCW, Holding Company Act for Health Care Service Contractors and Health Maintenance Organizations. GHS is also not reported in the GHC NAIC 2003 Annual Statement, Schedule D and Schedule Y, pursuant to the NAIC 2003 Annual Statement Instructions. (See Instruction No. 1.h. and No. 4)

Group Health of Washington (GHW)

GHW is a Washington nonprofit membership corporation. GHC trustees are the sole members of GHW. GHW has no assets and is inactive at the present time with regards to business activity.

GHC has not reported GHW as a subsidiary pursuant to Chapter 48.31C RCW, Holding Company Act for Health Care Service Contractors and Health Maintenance Organizations. GHW is also not reported in the GHC NAIC 2003 Annual Statement, Schedule D and Schedule Y, pursuant to the NAIC 2003 Annual Statement Instructions. (See Instruction No.1.h. and No. 4)

INTERCOMPANY AGREEMENTS

The Company had several in-force agreements with affiliates. As a member of an insurance company holding system, these agreements and any amendments with effective dates May 7, 2001 and later must be filed with the OIC pursuant to RCW 48.31C.050(2). As of December 31, 2003, the Company had the following intercompany agreements in force:

Administrative Services Agreement (ASA between GHC and GHO)

The current ASA was effective January 1, 2001 and has been subject to amendment over the years. It is indefinite in term, subject to termination with or without cause pursuant to the terms of the contract. Generally, GHO engages GHC to provide to or on behalf of GHO the administrative services described in Schedule A of the agreement all pursuant to all the terms and conditions of the agreement. The ASA and subsequent amendments have been filed with and commented upon in the Annual Registration Statement, Form B, as required by RCW 48.31C.040 of the Health Carrier Holding Company Act.

Medical Services Agreement (MSA between GHC & GHO)

The current MSA was effective January 1, 2001 and has been subject to amendment over the years. It is indefinite in term, subject to termination with or without cause pursuant to the terms of the contract. Generally, GHC performs as an independent contractor and provides covered medical care services to GHO enrollees who elect to receive care from GHC as described within this agreement. The MSA and subsequent amendments have been filed with and commented upon in the Annual Registration Statement, Form B, as required by RCW 48.31C.040 of the Health Carrier Holding Company Act.

Contribution Agreement (between GHC and GHCF)

This agreement, dated April 3, 2001, provides for the contribution by GHC of personnel and services to assist GHCF in its development and community service efforts, as approved in GHC's annual operating budget. At its sole discretion, GHC may make a contribution of funds necessary to support certain work of GHCF, but no other payments are called for by the agreement. This agreement has been filed with the OIC.

MANAGEMENT AND CONTROL

Ownership

The Company is organized as a nonprofit membership corporation under Chapter 24.03 RCW. Its Articles of Incorporation state that the corporation shall have no capital stock and that no one shall receive any pecuniary gain or benefit by reason of their membership in the corporation. Membership in GHC is open to those consumers who believe in its purposes and in democratic cooperative principles. Consumers apply for membership and are admitted to membership upon compliance with the requirements and procedures established by the Board of Trustees pursuant to the corporate bylaws. If the corporation is dissolved, any monies or assets remaining after payment of creditors and the return to members of the capital (membership fees) invested by each, shall be donated by the Board of Trustees to some public, nonprofit or charitable health organization having purposes similar to those of GHC.

Board of Trustees (BOT)

Control of the Company is vested in the BOT, which consists of eleven members pursuant to Article 3 of the Corporate Bylaws. Trustees are elected to three year terms at the annual membership meeting pursuant to Article 3.3 of the Corporate Bylaws. The terms shall be staggered according to the terms of office to achieve continuity of administration. Any trustee who has served three consecutive three-year terms shall be ineligible for re-election. The following individuals were trustees as of December 31, 2003:

Ruth Ann Ballweg	Jerry Franklin Campbell
Ann Elizabeth Daley	Rosemary Daszkiewicz
Aubrey Milton Davis	Ira Martin Fielding
Grant Hamro Hendrickson	Robert Paul Porterfield
William Elton Saraceno	Frances Margaret Selby Till
Deborah Huntington Ward	

Officers

Officers are elected for a one year term by the BOT at the first BOT meeting after each annual membership meeting pursuant to Article 4 of the Corporate Bylaws. Officers as of December 31, 2003 were:

Cheryl Marion Scott	President
Rick Dale Woods	Secretary
James Ward Truess	Treasurer
Grant Hamro Hendrickson	Chair, Board of Trustees
Ruth Ann Ballweg	Vice Chair, Board of Trustees
Peter Glenn Adler	Vice President
Scott Elliot Armstrong	Vice President
Maureen Patricia McLaughlin	Vice President
Pamela Ann MacEwan	Assistant Secretary
Carrie Jeanne Jennison	Assistant Treasurer

Conflict of Interest

The Company has adequate reporting procedures in place to reveal potential conflicts of interest to the BOT.

Fidelity Bond and Other Insurance

The Company is a named insured on a Financial Institution Fidelity Bond. An aggregate loss limit of coverage in the amount of \$10,000,000 is provided for all of the affiliated companies insured and the single loss deductible is \$50,000. The minimum amount recommended by the NAIC for the insured companies is \$2,000,000 to \$2,250,000. The aggregate amount of coverage meets the NAIC recommended level for the Company.

The Company is also provided protection against certain property and liability losses as a named insured on several other purchased insurance policies. Policies in effect at December 31, 2003 provided the following coverages:

- Directors and officers liability insurance including employment practices liability

coverage.

- Fiduciary liability.
- Professional, general, automobile and employers liability.
- Kidnap/ransom and extortion.
- Property.
- Excess workers' compensation.
- Errors and omission.

The Company also maintains a self insurance fund for professional liability risk, industrial insurance, and unemployment insurance. The Company reported a cash reserve in the amount of \$65,952,323 for that fund as of December 31, 2003, which included a small claim adjustment amount of \$201,991. The professional liability risk includes an amount to indemnify employees of the independent contractor GHP as agents of GHC.

Officers', Employees', and Agents' Welfare and Pension Plans

Group Health Cooperative maintains the following qualified retirement plans for the benefit of eligible employees: (1) Group Health Cooperative Employee Defined Contribution Plan, and (2) Group Health Cooperative 403(b)(7) Restated Group Custodial Account Agreement (Deferred Compensation).

Prepaid pension assets in the amount of \$44,398,365 were non-admitted pursuant to SSAP No. 8, paragraph 7, defined contribution plans. The Company also reported a liability for Retiree Medical Benefits in the amount of \$52,663,000. The OIC actuary reviewed the documentation provided by Milliman USA that supports the reserve.

The Company also has procedures in place to determine and monitor various accrued liabilities for salaries, severance pay, vacation pay and retirement benefits. No under accruals were noted and reasonable amounts were included as general expenses due and accrued.

ACTUARIAL REVIEW

The OIC health actuary reviewed the Company's actuarial report, claims unpaid, and other claim liabilities as of December 31, 2003. This review included: examining the Company's reserving philosophy and methods to determine the reasonableness of the claim liabilities, verifying that claim liabilities included provisions for all components noted in SSAP No. 55, paragraphs 7 and 8, reviewing historical paid claims and loss ratios, checking the consistency of the incurred-paid data from the Company system to the amounts reported in the 2003 NAIC Annual Statement, and estimating claims unpaid as of December 31, 2003.

The OIC health actuary determined that the Company's consulting actuary did not review a number of actuarial items that are required to be reviewed by the NAIC Annual Statement Instructions. (See Instruction No. 3) The OIC health actuary also noted other reconciliation issues as follows: (1) Paid Claims (See Instruction No. 1i), and (2) Active Life Reserves (See Instruction No. 1j).

The OIC casualty actuary reviewed the Company's actuarial reports with regards to the Company's self insurance reserves and determined the following:

- The professional liability reserve in the amount of \$56,705,004 was reviewed in an actuarial report prepared by an actuary with Milliman USA. The OIC casualty actuary determined that the booked reserves were adequate and did not recommend any examination adjustments to the reserves related to professional liabilities.
- The workers compensation reserve in the amount of \$7,512,796 was reviewed in an actuarial report prepared by an actuary with Marsh USA Inc. The report provided evidence that the reserves booked by GHC at year-end 2003 are within a range of reasonableness. The OIC casualty actuary did not recommend any examination adjustments to the liabilities related to workers compensation.
- The Company stated that the unemployment insurance reserve in the amount of \$1,734,522 was determined by taking 1% of gross payroll expense. The OIC casualty actuary did not receive any information supporting the use of the 1% or any other factors, therefore, the OIC actuary cannot comment on the adequacy of the amount that was reported.

The pension liability reserves were reviewed by an OIC life actuary using documentation supplied by the Company. It was determined that the actuarial assumptions and methodology used were reasonable, consistent and appropriate for the Company. The OIC life actuary considers the Company's provision for pension liability reserves adequate.

REINSURANCE

The Company was not in any reinsurance contracts as of December 31, 2003.

STATUTORY DEPOSITS

The Company has two required statutory deposits with the state of Washington as of December 31, 2003.

The State of Washington Department of Labor and Industries requires a statutory deposit pursuant to RCW 51.14.020(2) and RCW 51.14.060 to qualify as a self insurer. The Bank of New York Western Trust Company is holding a US Government Bond in the amount of \$5,257,000.

The OIC requires the filing of the Underwriting of Indemnity Calculation or Funded Reserve form. The security held was identified as a Bank of America Certificate of Deposit in the amount of \$150,000. The Certificate is being held by the custodian, Bank of New York Western Trust Company. This special deposit satisfies the funded reserve valuation requirements of RCW 48.46.240. The Company is in compliance with the filing requirements of WAC 284-07-050(8).

Both of the deposits were confirmed directly to the CPA performing the GHC annual statutory audit.

ACCOUNTING RECORDS AND INFORMATION SYSTEMS

The Company maintains its accounting records on a Generally Accepted Accounting Principles (GAAP) accrual basis of accounting and adjusts to Statutory Accounting Practices (SAP) basis for NAIC Annual Statement reporting. The Company is audited annually by the certified public accounting firm of Deloitte & Touche, LLP. The Company received an unqualified opinion for all years under review. The Company's accounting procedures, internal controls, and transaction cycles were reviewed during the planning and testing phase of the examination and no exceptions were noted.

During the review of Exhibit C – Information Systems Questionnaire, the records retention policy was reviewed. The policy states that retention standards shall be developed for all GHC records; the standards shall specify the relevant retention periods; and shall specify the primary holder of each record. GHC department managers are responsible for ensuring compliance with and maintenance of record retention policies and procedures.

A review of the submitted policy concluded that the policy was only a list of standards and does not include any of the specific information required to comply with GHC's standards. The policy does not identify the specific types of records to be retained, the retention period for each record type, and the primary holder for each record type. The policy does not provide either the GHC department manager or OIC examiner with any information that can be used to verify compliance with the retention policy. The retention policy needs to be revised to include the specific information relevant to the types of records being retained. (See Comments and Recommendations No. 4)

The Company's Information Systems Department provides data processing services and support for the administrative operations (accounting, premium billing, claims processing, etc.) and health plan facilities (clinics, specialty centers, hospitals, etc.) of the GHC.

Systems development, acquisition and maintenance controls were reviewed and evaluated. The internal controls for program changes need to be strengthened. GHC does not secure or limit access to programs after changes have been reviewed and approved, allowing a programmer access to the reviewed program and the opportunity to insert unauthorized changes prior to transferring the program into production. (See Comments and Recommendations No. 3)

Operations and application controls were reviewed to determine the type of hardware installed, operating systems and proprietary software in use, and the controls exercised to maintain data security. Appropriate internal controls are in place for the operation of the main frame and network systems.

During the examination period, GHC did not have a formal written business contingency plan that addresses the continuation of all significant business activities, including financial functions,

telecommunication services, and data processing services, in the event of a disruption of normal business activities, as recommended by NAIC guidelines. (See Comments and Recommendations No. 2)

During the examination period, GHC did not have a formal written and tested disaster recovery plan that includes appropriate escalation procedures to resolve operational failures of the IS system in a timely manner, as recommended by NAIC guidelines. (See Comments and Recommendations No. 1)

During the examination period, GHC did not have a written agreement or contract for the use of an alternative data center in the event the data facility necessitates relocation. (See Comments and Recommendations No. 5)

Subsequent to the examination period, GHC has been working with three different consulting groups to prepare a business contingency plan and a disaster recovery plan. Also, GHC has begun building a systems recovery site at its facility located in Spokane, Washington, which will function as a hot site.

SUBSEQUENT EVENTS

GHC acquired control of KPS Health Plans effective October 1, 2005.

GHC announced in 2003 its intention to form a strategic alliance with Overlake Hospital Medical Center (OHMC), a not-for-profit regional medical center located in Bellevue, Washington. The plan is for GHC to build a new specialty center adjacent to the OHMC campus, which will be designed to house outpatient and ambulatory specialty services, with OHMC providing inpatient care. The completion date for construction is scheduled for 2008.

FINANCIAL STATEMENTS

The following examination financial statements show the financial conditions of Group Health Cooperative as of December 31, 2003:

Assets, Liabilities, Capital and Surplus
Statement of Revenue and Expenses
Five Year Reconciliation of Surplus

GROUP HEALTH COOPERATIVE
ASSETS, LIABILITIES, CAPITAL AND SURPLUS
AS OF DECEMBER 31, 2003

	<u>BALANCE</u> <u>PER COMPANY</u>	<u>Ref.</u>	<u>EXAMINATION</u> <u>ADJUSTMENTS</u>	<u>BALANCE PER</u> <u>EXAMINATION</u>
Assets				
Bonds	\$253,111,348			\$253,111,348
Preferred stocks	100,000			100,000
Common stocks	26,214,848			26,214,848
Real estate:				
Properties occupied by the company	236,953,999	6		236,953,999
Properties held for sale	5,000,000			5,000,000
Cash and short-term investments	135,202,040			135,202,040
Aggregate write-ins for invested assets:				
Self insurance fund	23,247,318			23,247,318
Professional liability escrow	3,734,959			3,734,959
Funds held by trustee	492,545			492,545
Investment income due and accrued	3,153,370			3,153,370
Uncollected premiums and agents' balances	27,266,825			27,266,825
Electronic data processing equipment and software	7,836,796			7,836,796
Furniture and equip., incl. health care delivery assets	16,566,846	4	\$24,037,457	40,604,303
Health care and other amounts receivable	11,479,445			11,479,445
Aggregate write-ins for other than invested assets:				
Inventories	24,037,457	4	(24,037,457)	0
Total Assets	\$774,397,796		\$0	\$774,397,796
Liabilities, Capital, and Surplus				
Claims unpaid	\$110,939,869			\$110,939,869
Accrued medical incentive pool and bonus payments	146,789			146,789
Unpaid claims adjustment expenses	1,890,260			1,890,260
Aggregate health policy reserves	48,845,149	1 & 5	(\$45,750,221)	3,094,928
Premiums received in advance		1	40,965,125	40,965,125
General expenses due or accrued	59,213,406	2 & 3	(4,833,144)	54,380,262
Amounts withheld or retained for the account of others		1 & 2	11,269,615	11,269,615
Borrowed money and interest thereon	119,457,927			119,457,927
Amounts due to parent, subsidiaries and affiliates	11,655,309			11,655,309
Payable for securities	126,133			126,133
Aggregate write-ins for other liabilities:				
Retiree medical benefits	52,663,000			52,663,000
Self insurance fund	65,952,323			65,952,323
Summary of remaining write-ins	3,094,928	5	(3,094,928)	0
Unclaimed property		3	1,443,553	1,443,553
Total Liabilities	473,985,093		0	473,985,093
Common capital stock				0
Gross paid in and contributed surplus	16,207,926			16,207,926
Unassigned funds (surplus)	284,204,777			284,204,777
Total Capital and Surplus	300,412,703		0	300,412,703
Total Liabilities, Capital and Surplus	\$774,397,796		\$0	\$774,397,796

**GROUP HEALTH COOPERATIVE
STATEMENT OF REVENUE AND EXPENSES
FOR YEAR ENDING DECEMBER 31, 2003**

	<u>BALANCE PER COMPANY</u>	<u>EXAMINATION ADJUSTMENTS</u>	<u>BALANCE PER EXAMINATION</u>
Member months	5,342,456		5,342,456
Net premium income	\$1,424,327,321		\$1,424,327,321
Change in unearned premium reserves	2,306,014		2,306,014
Fee-for-service	133,849,085		133,849,085
Risk revenue	242,433,582		242,433,582
Aggregate write-ins for other health care related revenues	765,427		765,427
Total revenues	<u>\$1,803,681,429</u>	<u>\$0</u>	<u>\$1,803,681,429</u>
<u>Hospital and Medical:</u>			
Hospital/medical benefits	233,099,716		233,099,716
Other professional services	344,193,755		344,193,755
Outside referrals	704,557,081		704,557,081
Emergency room and out-of-area	19,915,327		19,915,327
Prescription drugs	124,566,415		124,566,415
Aggregate write-ins for other hospital and medical	22,532,067		22,532,067
Incentive pool, withhold adjustments and bonus amounts	146,789		146,789
Subtotal	1,449,011,150	0	1,449,011,150
<u>Less:</u>			
Net reinsurance recoveries	0		0
Total hospital and medical	1,449,011,150		1,449,011,150
Claims adjustment expenses	84,745,291		84,745,291
General administrative expenses	122,459,171		122,459,171
Total underwriting deductions	1,656,215,612	0	1,656,215,612
Net underwriting gain or (loss)	147,465,817	0	147,465,817
Net investment income earned	10,491,837		10,491,837
Net realized capital gains or (losses)	4,165,457		4,165,457
Net investment gains or (losses)	14,657,294	0	14,657,294
Aggregate write-ins for other income or expenses	25,691,560		25,691,560
Net income or (loss) before FIT	187,814,671	0	187,814,671
Net Income (Loss)	<u>\$187,814,671</u>	<u>\$0</u>	<u>\$187,814,671</u>
<u>CAPITAL AND SURPLUS ACCOUNT</u>			
Capital and surplus prior reporting period	\$176,204,100		\$176,204,100
Net Income (Loss) from above	187,814,671		187,814,671
Net unrealized capital gains and losses	4,077,531		4,077,531
Change in nonadmitted assets	(54,604,333)		(54,604,333)
Surplus adjustments:			
Paid in	(104,854)		(104,854)
Aggregate write-ins for gains or (losses) in surplus:			
2002 Audit Adjustments	(12,974,412)		(12,974,412)
Net change in capital and surplus	124,208,603		124,208,603
Capital and surplus end of reporting period	<u>\$300,412,703</u>	<u>\$0</u>	<u>\$300,412,703</u>

**GROUP HEALTH COOPERATIVE
FIVE YEAR RECONCILIATION OF SURPLUS
FOR THE YEARS ENDING DECEMBER 31**

	<u>2003</u>	<u>2002</u>	<u>2001</u>	<u>2000</u>	<u>1999</u>
Capital and Surplus, Prior Reporting Year	<u>\$176,204,100</u>	<u>\$172,085,943</u>	<u>\$151,677,950</u>	<u>\$126,266,841</u>	<u>\$129,305,089</u>
Net income or (loss)	187,814,671	(6,963,311)	20,848,539	24,151,042	(5,050,209)
Change in valuation basis of aggregate policy and claim reserves					
Net unrealized capital gains and losses	4,077,531	(3,848,062)	5,052,812	1,491,640	41,233
Change in nonadmitted assets	(54,604,333)	(11,726,556)	(16,108,432)	(232,864)	(10,055,173)
Cumulative effect of changes in accounting principles		26,719,503	10,814,681		
Surplus adjustments:					
Paid in	(104,854)	(63,417)	(199,607)	249,326	240,984
Aggregate write-ins for gains or (losses) in surplus:					
2002 Audit adjustment	(12,974,412)				
Members equity transfer from GHNW					12,043,414
Increase (Decrease) in Capital Dues				(139,752)	(148,665)
Increase (Decrease) in Memberships				(108,283)	(109,832)
Net change in capital and surplus	<u>124,208,603</u>	<u>4,118,157</u>	<u>20,407,993</u>	<u>25,411,109</u>	<u>(3,038,248)</u>
Capital and Surplus, End of Reporting Period	<u>\$300,412,703</u>	<u>\$176,204,100</u>	<u>\$172,085,943</u>	<u>\$151,677,950</u>	<u>\$126,266,841</u>

NOTES TO THE FINANCIAL STATEMENTS

Examination adjustment notes 1 through 5 were made to address reporting errors in the 2003 NAIC Annual Statement. Note 6 is a special consent granted by OIC for investments in properties occupied by the Company.

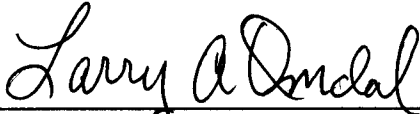
1. The following items were incorrectly included in Aggregate health policy reserves and have been reclassified to appropriately account for them. This reclassification adjusts for the 2003 NAIC Annual Statement reporting error whereby Premiums received in advance (\$40,965,125), a rental deposit (\$45,123) and another Amount held for the account of others (\$7,834,901), were reported as Unearned premium reserves in a supporting 2003 NAIC Annual Statement exhibit, and reflected in the balance sheet collectively as Aggregate health policy reserves (\$48,845,149).
2. This reclassification adjusts for the 2003 NAIC Annual Statement reporting error whereby miscellaneous payroll deductions (\$3,389,591) were misclassified as General expenses due and accrued.
3. This reclassification adjusts for the 2003 NAIC Annual Statement reporting error whereby unclaimed property (\$1,443,553) was reported as General expenses due or accrued.
4. This reclassification adjusts for the 2003 NAIC Annual Statement reporting error whereby the entire inventory of health care supplies (\$24,037,457) was misclassified as Aggregate write-ins for other than invested assets when there is a specific asset line provided for the inclusion of health care delivery assets.
5. This reclassification adjusts for the 2003 NAIC Annual Statement reporting error whereby active life reserves (\$3,094,928) were misclassified as Aggregate write-ins for other liabilities when they should have been reported as Aggregate health policy reserves.
6. The Company received an exception to the investment requirement that limits the amount of surplus that can be invested in properties occupied by the Company. Pursuant to RCW 48.13.250 the OIC approved special consent investment No. 83 dated February 7, 1994. This was allowed considering that GHC is a staff model HMO and requires these facilities to deliver contracted health care services to its enrolled participants. The Company has no other special consents, permitted practices or orders from the state of Washington.

ACKNOWLEDGMENT

Acknowledgment is hereby made of the cooperation extended to the examiners by the officers of Group Health Cooperative during the course of this examination.

In addition to the undersigned, Michael V. Jordan, CPA, CFE, MHP, Assistant Chief Examiner; Carl M. Baker, CPA, CFE, CISA, Supervising Examiner; John Jacobson, AFE, Information Systems Specialist; Lichiou Lee, ASA, MAAA, Health Actuary; Lee Barclay, FCAS, MAAA, ARM, Senior Actuary; Alexis S. Santos, FSA, MAAA; Adrienne DeBella, Insurance Examiner; Friday P. Enoye, Insurance Examiner and Youngjae Lee, Insurance Examiner; all from the Washington State Office of the Insurance Commissioner, participated in the examination and the preparation of this report.

Respectfully submitted,

A handwritten signature in cursive script, reading "Larry A. Omdal", is written over a horizontal line.

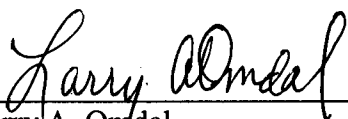
Larry A. Omdal
Examiner-in-Charge
State of Washington

AFFIDAVIT

STATE OF WASHINGTON }
 }
COUNTY OF KING } ss
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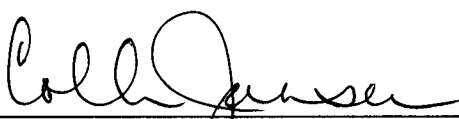
Larry A. Omdal, being duly sworn, deposes and says that the foregoing report subscribed is true to the best of his knowledge and belief.

He attests that the examination of Group Health Cooperative was performed in a manner consistent with the standards and procedures required or prescribed by the Washington State Office of the Insurance Commissioner and the National Association of Insurance Commissioners (NAIC).



Larry A. Omdal
Examiner-in-Charge
State of Washington

Subscribed and sworn to before me this 1st day of September, 2006.



Notary Public in and for the
State of Washington

